

A Constructive Method for the
Regulation of Railroads by the
Governments, State and National

—PROPERTY OF
LOUIS D. BRANDEIS

A SPEECH

BY

GEORGE STUART PATTERSON

General Solicitor of the Pennsylvania Railroad Company

BEFORE THE

Pennsylvania Bankers' Association

(Group No. 1)

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A SPEECH DELIVERED ON FEBRUARY 5TH, 1915,
BEFORE THE PENNSYLVANIA BANKERS' ASSOCIATION,
(GROUP NO. 1), BY GEORGE STUART PATTERSON, GEN-
ERAL SOLICITOR OF THE PENNSYLVANIA RAILROAD
COMPANY.

On July 29th last, the Interstate Commerce Commis-
sion, in its first opinion in the "Five Per Cent Case"
(31 I. C. C., 350), said (page 384):—

"In view of a tendency towards a diminishing net operating income, as shown by the facts described, we are of opinion that the net operating income of the railroads in official classification territory, taken as a whole, is smaller than is demanded in the interest of both the general public and the railroads; and it is our duty and our purpose to aid, so far as we legally may, in the solution of the problem as to the course that the Carriers may pursue to meet the situation."

Let me ask your attention for a moment to the facts disclosing the inadequacy of the Carriers' revenues and the causes contributing to such inadequacy, as shedding some light upon certain elements of weakness in the present system of governmental regulation.

INADEQUACY OF REVENUES.

Taking the 15-year period, 1900-1914,* we find that the combined figures for the 35 Eastern Railroad Systems show an additional investment in that period in Road

* NOTE.—Fiscal years ending June 30th are used in this paper.

and Equipment of approximately \$2,500,000,000, with an increase of only \$52,000,000 in net operating income, or 2.1 per cent. on the increased investment.

The 5-year period, 1910-1914, the first year of which marked the first effort of the Eastern Carriers to secure a general advance in rates, furnishes figures even more impressive. In that period, the 35 Systems invested 900 millions of dollars in tracks, yards, stations and equipment, and other portions of their transportation plant, and at the end of the period found themselves with 93 millions of dollars less of net operating income than they had before this investment was made.

If you are not satisfied with a comparison based simply upon the figures for 1900, 1910 and 1914, you may compare the averages for fairly typical series of years within the period, and you will find the same tendencies; or, if it be said that the figures for the 35 Systems combined prove nothing, take the separate figures of the Baltimore & Ohio, the New York Central and the Pennsylvania Systems, which Systems were designated by the Commission as typical of the situation in this territory, and you will see a failure in recent years to earn such return from the operation of the transportation plant, as would justify the investment of capital in any further substantial development of the same.

And now as to the causes; they are neither obscure nor complex.

CAUSES OF THE INADEQUACY IN REVENUES.

Primarily, they represent disproportionate increases in expenses, not falling off in business, nor reductions in rates or diminution of gross revenues. Traffic and gross operating revenues have steadily increased during the period under consideration. The fiscal year ending June 30th, 1914, is often spoken of as a year of poor traffic for the railroads. The fact is that in that year (in which the net earnings are so alarmingly low) the operating revenues of the Carriers were the largest in their

history, save 1913, and were only 3.4 per cent. less than in 1913. Generally speaking, there have been no substantial reductions of rates in this territory during this period, with the exception of the reduction in passenger rates caused by the "Two-cent" fare laws of Ohio, Indiana, Illinois, Michigan and West Virginia, some few freight rates, and the reduction in Railway Mail Pay.

The fundamental trouble lay in the disproportionately increasing relation of operating expenses and taxes to operating revenues. Taxes paid in the year 1914 were 35 millions of dollars higher than in 1900, and 14 millions of dollars higher than in 1910.

There have been substantial and continued increases in wages on the railroads in this territory since 1901, the figures for 1913, the last year available, showing an increase of over 50 millions of dollars for that year as compared to 1910, and since 1913 a number of other increases have become effective, which are reflected in the operating expenses of 1914, and of the current year.

Maintenance of way and maintenance of equipment expenses have been increasing per transportation unit, and will continue at this higher level, due to the use of steel equipment, the installation of automatic signals, and the elevation of tracks, all of which have made for an enlarged and more costly transportation plant, which naturally involves more cost in its replacement.

Other factors of increased expense have been due to a compliance with statutes, State and National, some justifiable in principle, such as compensation acts and automatic-coupler laws; others without the slightest justification, such as extra-crew laws, the burden of which on the Pennsylvania Lines East of Pittsburgh alone was approximately \$800,000 in 1914.

The theory upon which Railroad Commissions have been organized by the States was the creation of a body of experts to determine technical railroad questions rather than have them settled by the Legislature, who have no technical information regarding such subjects. This theory has utterly failed in practice. Notwith-

standing the existence of these Commissions, laws regulating freight and passenger rates have been enacted, as well as laws regulating operating conditions, such as extra-crew laws, and grade-crossing laws. One State indeed enacted an extra-crew law and a law with reference to the elimination of grade crossings after the proposed Acts had been carefully examined and expressly condemned by the Public Utility Commission of that State.

In the year 1913, one thousand, three hundred and ninety-five bills, regulating the details of practical railroad operation, were introduced in the legislatures of the various States then in session, and two hundred and thirty of those bills were enacted into law. Amongst these laws were Acts regulating the hours of service, time of payment, and terms of employment of employees, rules for flagging trains, prescribing the kind of headlight, equipment of passenger trains, speed of live stock and other freight trains, protection and elimination of grade crossings, equipment of stations and shops, etc.

The increases in operating expenses and taxes of the railroads due to the causes heretofore referred to, have thus more than counter-balanced the economies derived from increased traffic and transportation efficiency, such as increases in the tractive power of locomotives, in capacity of cars, in average freight train load, and in average freight car load, etc.

We have had then in the past this method of governmental regulation.

Rates for the transportation of passengers, freight, express and mails have been prescribed by the Interstate Commerce Commission, by State Commissions, by Congress, by the Post Office Department, and by State Legislatures, while operating expenses and taxes have been increased by Acts of Congress, awards under the Federal Wage Arbitration Act, Acts of State Legislatures and orders of State Commissions. Is it any wonder that the result has been an alarming decrease in the return on the property investment of the Carriers?

THE DECISION OF THE INTERSTATE COMMERCE COMMISSION IN THE FIVE PER CENT. CASE.

To meet this situation so fraught with danger to the public interest, the Interstate Commerce Commission has by its recent decision in the "Five Per Cent. Case," authorized increases in rates on approximately 50 per cent. of the freight traffic in this territory, and has also emphasized certain suggestions to the Carriers as to other means of increasing their revenues, such as by raising passenger rates, increasing particularly low freight rates more than 5 per cent., as well as various other suggestions, all of which are being pursued by the Railroads.

The decision of the Interstate Commerce Commission is a great step forward in the proper solution of the problem, quite apart from the additional revenues which will accrue under the specific increases authorized.

First.—The decision sustains unequivocally the contention of the Carriers that their existing revenues are inadequate; that such tendency is contrary to the public interests, and should be remedied by a general increase of nearly all freight rates.

Second.—The opinion states that the aid of the Commission will be further extended to the Carriers in helping them to overcome the present inadequacy of their revenues.

Third.—The decision states that the Commission do not "view with favor any attempt to obtain an increase in net revenue through unduly restricted expenditures upon maintenance."

Fourth.—The co-operation of the Commission in securing increases in passenger rates, particularly low freight rates, and the imposition of additional charges for special services where no charge has heretofore been made, or if made has been too low.

I submit that this opinion and decision has already and will still even more in the future, tend to restore business confidence.

Helpful though this decision is, there remain further steps to be taken so as to place governmental regulation on a sound economic basis. Let me give you some of the suggestions which have been made by others more qualified to speak than I am.

SUGGESTIONS FOR A CONSTRUCTIVE POLICY IN RAILROAD REGULATION.

(a) The public must be afforded, by fair and accurate statement from time to time, a clearer understanding than they have had in the past, of the problems of the Railroads. If the public had been fully advised as to the facts they would have appreciated the economic injury of legislation unduly increasing taxation, and reducing rates such as "two-cent fare" laws, or laws increasing operating expenses by limiting operating efficiency, such as extra-crew laws, or Acts limiting the number of cars in a freight train.

The public appreciates that it is wise that steel cars shall be gradually substituted for wooden ones, that the work of installing automatic signals shall be completed, that grades, curves and grade crossings shall as far as possible be eliminated, that facilities for handling passengers and freight shall keep pace with the demand therefor, and generally, that the railroads shall be maintained in a high state of efficiency. If the public had a clearer understanding of the facts, they would have understood that to secure these improvements new capital must be obtained, and that in obtaining it, it would be wiser to secure (if possible) partners in the enterprise, through issues of capital stock rather than acquire that capital by issuing bonds and other obligations, and they would have seen that such stock issue cannot be made unless the return on existing capital be a fair and reasonable return. Recent events have proved beyond peradventure that the nation can not prosper unless the railroads prosper, and a sound public policy requires that we all be so advised of the situation that the mistakes of the past be not repeated.

In this connection, the valuation of the railroads now being undertaken at a large expense both to the Carriers and to the Federal Government, will be of distinct value. It will end the too prevalent idea of over-capitalization of railroads, an idea assiduously disseminated through the medium of a few glaring instances; and it will clearly show (in my opinion) that in most instances the property investment accounts of the Carriers are under and not over-stated and that the present general basis of rates furnishes an inadequate return on such investment.

(b) The jurisdiction of the Federal Commission should be extended, and that of the States curtailed, in connection with the issue of railroad securities. The Federal Commission should be given the power, not to permit or prohibit the issue of securities, but to require full publicity of such issues, and equal publicity as to the application of the proceeds thereof. This power so given, will prevent the issuance of securities for improper purposes, and at the same time will have the advantage of not substituting the discretion of the Government for the discretion of the Railroad management as to the purposes for which the issue should be made.

Such a plan will also remove the injurious delay which would necessarily result if governmental permission had to be obtained before the issue could be made and it has the further advantage of not placing the government in the position whereby its approval to an issue of securities is regarded as a moral guarantee of their financial soundness.

(c) The Federal Commission should exercise full control over all State rates or practices which directly or indirectly affect interstate commerce. There are to-day many instances where the States in prescribing improperly low freight rates necessarily reduce interstate competitive rates. Furthermore, no State authority should be permitted to force upon the Carriers either unduly low rates, or unduly high operating expenses by extra-crew or other laws, for the resultant financial burden must fall upon interstate traffic and traffic in other

States. Neither is there any justification for the present duplication of the labor and consequent expense imposed upon the Carriers in complying with both State and Federal Laws resulting the same subject, as, for example, the making of accident reports, boiler inspection, &c.

(d) The Federal Commission should be enlarged, and their salaries increased so as to make such salaries commensurate with the duties and responsibilities of the position.

The railway industry of the United States has nearly fifteen and one-half billions of dollars of its securities in the hands of life insurance companies, savings banks, trust estates and individuals. The employees of that industry aggregated in 1913 over one million, eight hundred thousand, and their yearly compensation amounted to \$1,373,830,589. There are few positions in the United States which carry a greater responsibility than that of membership in the Commission which controls to so large an extent, the price to be charged by the railway industry for its product.

The present burden of work of the Federal Commission should be materially lightened in many ways, and with a membership so enlarged and with a curtailment of their duties, the personal attention of all the Commission would be available for many matters which are now necessarily delegated to subordinates.

To a Commission so constituted could be delegated the question of a reasonable compensation to the Railroads for carrying the mails. Notwithstanding the large increase in operating expenses in the last eight years, the Government has made substantial reductions in railway mail pay, so that it is quite conservative to say that during this period the Railroads have been consistently underpaid for carrying the mails, and particularly since the establishment of the parcels post.

At the hearings held during the last two years before the Joint Congressional Committee on Railway Mail Pay, a statistician of the Interstate Commerce Commission, who had been retained by the Congressional Committee,

reported to that Committee that an increase in Railway mail pay, of at least 10 per cent. as a minimum, was warranted. The secretary of the Congressional Committee also made an investigation for, and report to, the Committee that under the present basis, the Railroads were underpaid approximately 12 millions of dollars, while the Committee itself has reported to Congress a bill increasing the present pay by some 3 millions of dollars, and permitting the matter to be brought to the attention of the Interstate Commerce Commission for investigation and report at the expiration of two years.

The advice of the Commission should also be asked on pending Congressional legislation affecting railroads, and they should be specifically required to point out to Congress and the country at large the economic effect of Federal and State railroad legislation.

Such a practice, if it had prevailed in the past, would have led to the development of a sound public opinion which would have prevented the passage of many of the State laws heretofore referred to.

The Commission should be also empowered to prevent the reduction of rates already reasonably low and to force an increase in rates now inadequate.

In other words, the functions of the Commission should be made expressly constructive with respect to railroad credit and facilities, and there is no economic or legal justification for the theory, which would restrict their activities to preventing extortion and unjust discrimination, and which theory, if persisted in must necessarily result in the diminution of railway net income and the consequent injury to the public interests.

(e) The Interstate Commerce Commission should to some extent participate in wage arbitrations under the Federal Arbitration Act, and thus remove the present anomaly under which the branch of the Government granting an increase in wages has no official relation to the Commission which controls the rates from which must come the increase in wages.

(f) The present procedure before all Commissions,

State and Federal, should be substantially modified so as to limit the amount of testimony taken at hearings before Commissions, with the consequent reduction in expense, public and private, as well as effecting a substantial saving of time to shippers and railroad officers in attendance at such hearings.

(g) There should be more co-operation between Carriers and Commissions than generally exists to-day. Whether the fault be that of the Carriers or of the Commissions, or of both, is of little importance. There can not be efficient regulation without such co-operation.

(h) The power of the Commissions, State and Federal, to suspend rates should be substantially curtailed, both with respect to the time covered by the suspension, and also as to the cases in which that power shall be exercised, and thus save the Carriers the revenues which are now being lost to them during the period of suspension, the rights of the shipper being protected by the power to grant reparation.

The dominant thought of the day is efficiency and Governmental encouragement and not discouragement to business. We have recently enacted legislation with the avowed purpose of increasing banking facilities and strengthening credit. If we could make governmental regulation of railroads equally responsive to strengthening railroad credit, and providing railroad facilities for the growing business of the country, we will have gone far in solving the problem of insufficient revenues which the Commission found in the Five Per Cent. Case to be so injurious to the public welfare.

